# Alternative Minimum Tax on C-Corps

(Draft as of 7/28/03) by David Downs

### 1. What it is:

Every corporation subject to the Arizona Income Tax Act of 1978 that engages in a trade or business or has income from the state must file an Arizona corporate income tax return. This includes C-corporations and Limited Liability Companies (LLC) classified as corporations. C-corporations and LLCs file Form 120 income tax return.

Currently, the net income of corporate taxpayers is subject to a regular tax rate of 6.968%. Arizona does not have an alternative minimum tax.

For federal income tax purposes, an alternative minimum tax must be considered. Certain corporations are required to recompute taxable income based on a variety of adjustments and preferences to determine the alternative minimum taxable income (AMTI). The AMTI exceeding the \$40,000 exemption is subject to 20% alternative minimum tax (AMT). This tax amount is then compared to the regular income tax. If the AMT exceeds the regular tax, the corporation must pay the excess as an alternative minimum tax in addition to the regular tax amount. The federal AMT concept is to collect some taxes from corporations that have book income but through certain preferential tax deductions (such as accelerated depreciation) have been able to significantly reduce their taxable income and thus reduce or eliminate their tax liability. Federal exempts "small" corporations from paying AMT. A small corporation has average gross receipts of the prior 3 tax year periods of less than \$7.5 million.

The proposal before this commission is applying an alternative minimum tax to adjusted net income of corporations.

### 2. How it would be administered:

The alternative minimum tax is collected with the filing of the corporate income tax return, quarterly estimated tax payments or the filing of an extension by the original due date of the return. The tax is transmitted either by check or electronic funds transfer to the State. It is collect no differently than the regular corporate income tax.

The AMT would be calculated and determined by each taxpayer on its corporate income tax return, Form 120. Most likely an additional form would be created to facilitate the reporting and determination of the tax.

The administration process would be incorporated with the filing of the corporate income tax return.

## 3. Impact on Existing Revenue Systems:

We do not expect the application of the alternative minimum tax to directly affect other revenue systems.

It may have a secondary affect on other current revenue sources, as it will increase business expense. This could effect dividend distributions or other business investments and expenditures.

#### 4. **Cost**:

The cost of administering the alternative minimum corporate tax would be modest because the mechanisms for collecting and processing the tax are already in place for the regular corporate income tax. The current processes would be enhanced to accommodate the additional tax.

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We believe the compliance cost to corporate taxpayers would be modest. The taxpayer will need to calculate the tax not only for the tax return but also for quarterly estimated tax payments. This may require modifications to commercial tax preparation software or in-house templates. The remittance of the tax remains the same as for the regular tax.

## 5. **Policy Considerations**:

# A. Equity

Alternative minimum tax is not evenly applied across all corporate taxpayers in horizontal equity. Taxpayers that are in businesses that have the preferential tax deductions would pay tax where their counterparts with the same amount of income in a different line of business would not.

The tax can have some vertical equity if small corporate taxpayers and those with AMTI less than an exempt amount such as \$40,000 are not subject to the tax.

# **B.** Economic Vitality

California and Florida are the two states among the 10 comparison states to apply an alternative minimum tax. The California AMT rate is 6.65% and Florida AMT rate is 3.3%. Each uses the federal method as a blue print in determining the state AMTI.

#### C. Volatility

The level of revenue raised by the corporate alternative minimum tax is likely to be highly volatile as it is subject to economic swings, net profits, depreciable assets or other business climate factors as it relates to the amount of regular income tax. There is insufficient data to accurately reflect the volatility.

# **D.** Simplicity

We believe the application of the corporate alternative minimum tax is difficult and adds an additional level of complexity to the corporate income tax system. The current federal trend is to reduce the number of taxpayers affected by AMT.

## 6. Economic Impact:

There is insufficient data to determine the revenue impact

## 7. **Other**:

Arguments of applying an alternative minimum tax are the following:

Corporations with book income will pay at least some corporate income tax.

The new tax can be incorporated into the existing corporate income tax process and filings.

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The alternative minimum taxable income determination can be a piggyback from the federal calculation.

Arguments against applying an alternative minimum tax are as follows:

The minimum tax would exceed all comparison states except for California and Florida.

This parallel tax is complex and is not business friendly.

The federal trend is to reduce the number of taxpayers subject to the tax.

The revenue is volatile.